

LETTER FROM EDOUARD CARMIGNAC

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EDOUARD CARMIGNAC'S LETTER

Edouard Carmignac writes on current economic, political and social issues each quarter.

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Dear Investor,

In Lewis Carroll's tale, after Alice's first incredible journey into Wonderland, she feels the irresistible urge to step "Through the Looking-Glass" to expand her view of the world.

In a way, recent trends in financial markets similarly require us to adjust to a world in which conventional logic no longer holds. How indeed do you explain the impressive rally across equity markets, as well as bond markets, since the beginning of the year, while at the same time economic growth is deteriorating, particularly here in Europe?

The dramatic stock-market sell-off in the fourth quarter was fuelled by more than just fears of a

global economic slowdown. It was also considerably amplified by forecasts of a contraction in global liquidity, maintained by the Federal Reserve as it attempts to combat the risk of resurgent inflation and give itself enough room to manoeuvre to be able to deal with any future weakness in economic activity.

Jerome Powell was no doubt acting out of a desire to avoid compounding the US economic slowdown when he reversed course. But the abrupt about-face he initiated on January 4th should, in our view, be attributed to another, more crucial factor – a growing awareness that the powerful deflationary forces unleashed by globalisation and technological upheaval **have eradicated the risk of inflation in developed countries**. Channelling the Bank of Japan and the ECB, the Fed can be expected to follow an accommodative monetary policy so as to sustain US economic momentum and keep a strong dollar from impeding it.

The key question at this point is how we in the fund management industry should respond to this environment of slow growth and persistently low interest rates. In the current period of sluggish economic activity and weak inflation, fixed income managers will have to contend with an increasingly fragile credit market. A growing proportion of sovereign debt will be held by central banks – essentially meaning it will never be repaid. Fixed income managers will therefore have to be nimble enough to seize the opportunities created by those dislocations in both the debt and forex markets. The challenge facing equity fund managers will be to identify those few companies with long-term growth prospects – plus the ability to protect their profit margins. These strengths will earn those firms a valuation premium. Unsurprisingly, tech companies and traditional companies that have incorporated new technology will figure prominently among the winners, along with a smaller cohort of emerging market names.

Over the past few years, I have worked to build up a team of experts that have what it takes to cope with these major shifts. It will be up to you, the investor, to look beyond the first quarter and judge their qualities over the long term. I trust that you will judge them wisely.

Yours sincerely,



Edouard Carmignac



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